McNeillLawOffices
GOVERNMENT FEE LITIGATION

September 7, 2013

Craig Benedetto, NAIOP – San Diego
craigb@calstrat.com
&
Borre Winckel, BIA – San Diego
borre@biasandiego.org

re: MEMO re: Challenge to proposed City of San Diego "Linkage" Fees

Dear Craig and Borre,

A question put to me about a legal challenge to the San Diego "Linkage" Fees is: How would this challenge be different –in light of the *Koontz* decision and Prop 26-- from past lawsuits that upheld fees like this, and would we have a reasonable chance of success?

In summary, it is my opinion that Prop 26 and *Koontz* have dramatically changed the legal landscape in California for government imposition of fees generally (Prop 26) and specifically as to any fees charged as a condition to develop land (*Koontz*). That makes all the difference. And, though I think a valid challenge to the "Linkage" Fee might have been made under the prior law, I believe we now would have a good and more than reasonable chance of success in striking down this "Linkage" Fee.

At the outset, in my view the "Linkage" Fee we are looking at in San Diego is a *regulatory fee* as opposed to a true "development impact fee" under the Mitigation Fee Act (Gov. Code §66000 et seq.), because non-residential construction does not *cause* "unaffordable housing," and the funds collected are not spent on *public* facilities or *public* services but rather support a broad based regulatory program aimed at improving housing opportunities for lower income workers—redistributing funds from commercial builders to *private* individuals to aid in their housing. Commercial buildings are to some degree associated with and go along with or accompany economic growth, but they are the result of economic growth and not the *cause*; then from there, to connect buildings to housing, it requires a chain of speculative and/or arbitrary assumptions that the purportedly "new" workers in "new" commercial buildings are making housing in San Diego less affordable and to what degree. When the City conditions issuance of a building permit on payment of the Linkage Fee it merely makes the building permit the "hook" or "choke point" for collection of the Fee it wants for partial funding of its ongoing regulatory

affordable housing program.

Prior to Prop 26 (approved by the voters Nov. 2, 2010) and the *Koontz* decision (*Koontz v. St. Johns River Water Management District* –- S.Ct. ---, June 25, 2013 WL 31842628 (U.S.Fla.) ["*Koontz*"]) *regulatory fees* of this nature were upheld by the California courts and the Ninth Circuit federal courts, on the ground that a general associational relationship between the fee payor and the use of the fee funds was sufficient to support a legislative regulatory fee of general application. (*Sinclair Paint v. State Bd. Of Equalization* (1997) 15 Cal.4th 866 ["*Sinclair Paint*"]; *Commercial Builders of Northern California v. City of Sacramento* (1991) 941 F.2d 872 ["*Commercial Builders*"]; *McClung v. City of Sumner* 548 F.3d 1218 (2008) ["*McClung*"]; *California Building Industry Association v. San Joaquin Valley Air Pollution Control District* (2010) 178 Cal.App.4th 120 ["SJVAPCD"]. The City's legal basis and justification for the upcoming increase in the Linkage Fee rests almost entirely on the Keyser Marston Associates, Inc. "Nexus Study" dated August 2013. However, that Nexus Study is based entirely on the law as it existed *before* Prop 26 and the *Koontz* decision. It is basic incompetence for any nexus study from 2011 forward to fail to address Prop 26 (it should be noted that the March 5, 2011 SD Housing Commission Report to the City Council requesting increased Linkage Fees shows the request of the Land Use and Housing Committee "that the City Attorney work with IBA (Independent Budget Analyst) to identify what Municipal Code changes would be required and if Proposition 26 would have an impact on the suggested mechanism or methodologies that the IBA is reviewing" for collecting Linkage Fees); and even though the *Koontz* decision was only 2 months old when this Study was released, Keyser Marston cannot be unaware of the significance of the decision, but made no mention of it in the Study. As explained further, the Nexus Study is fatally flawed and can't serve as a legitimate foundation for the City to enact or increase the Linkage Fee.

Proposition 26

Prop 26 amended the California Constitution (Art. XIII C §1) and completely changed the legal paradigm for judging the validity of fees and charges imposed by local agencies in California. (It received surprisingly little attention from the media in the November 2010 election, largely because other issues on the ballot dominated the news.) It was the outgrowth of frustration with the unchecked proliferation of fees and charges that are really "hidden taxes," especially fees to simply raise revenues for regulatory programs. The onslaught of new fees had been made possible by the California Supreme Court's decision in *Sinclair Paint*[1] and appellate decisions in its wake, that: gave

[1] In *Sinclair Paint* a paint manufacturer challenged a new fee charged for every bucket of paint to help the State pay for a lead screening program for children potentially exposed to lead from lead based paint—though lead had been banned from the manufacture of paint for well over 15 years. The paint company challenging the fee didn't even exist when lead was a common ingredient in paint. The Supreme Court generally classified fees/charges as falling into categories of (1) special assessments, (2) development fees, or (3) regulatory fees. It upheld the fee imposed on the paint industry as a bona fide *regulatory fee*, stating that it is constitutionally permissible under the police power to impose industry-wide fees to address the *past, present or future impacts* of the industry's operations, and that such fees are a valid method to shift the "societal costs" from the government to the industry, regardless that the industry and its fee payers had not been responsible for these impacts for many years.

every new fee a presumption of validity; that put the burden on fee payers to prove there was *no evidence* to support a fee; that allowed fees for regulatory programs based on a general associational relationship between the class of fee payers and the societal problem to be solved by the use of the fee revenues; and that allowed fees that were not apportioned to fee payers in relation to the payers burdens on or benefits from the governmental activity. Prop 26 turned the tables on that. Now *any* fee or charge created by a local agency is *defined to be a tax* unless the *local agency* can *prove* that it is not a tax by showing that it fits within one of seven specific exceptions that allow certain defined types of fees/charges. The burden of proof is *on the local agency* to show by a *preponderance of the evidence* that the fee is not a tax and that it is reasonably allocated to fee payers. Deliberately absent from the list of exceptions for permissible fees are *regulatory fees* of the type allowed by the *Sinclair Paint* decision. Very simply, Prop 26 puts an end to new or increased regulatory fees; they must now be approved by the voters as taxes.

Therefore the threshold analysis of the validity of any "fee" or "charge" adopted or increased by a City in California is whether the fee fits into one of the 7 exceptions for which fees are permissible. The language of Art. XIIC §1 reads:

(e) As used in this article, "tax" means any levy, charge, or exaction of any kind imposed by a local government, except the following:

(1) A charge imposed for a specific benefit conferred or privilege granted directly to the payor that is not provided to those not charged, and which does not exceed the reasonable costs to the local government of conferring the benefit or granting the privilege.

(2) A charge imposed for a specific government service or product provided directly to the payor that is not provided to those not charged, and which does not exceed the reasonable costs to the local government of providing the service or product.

(3) A charge imposed for the reasonable regulatory costs to a local government for issuing licenses and permits, performing investigations, inspections, and audits, enforcing agricultural marketing orders, and the administrative enforcement and adjudication thereof.

(4) A charge imposed for entrance to or use of local government property, or the purchase, rental, or lease of local government property.

(5) A fine, penalty, or other monetary charge imposed by the judicial branch of government or a local government, as a result of a violation of law.

(6) A charge imposed as a condition of property development.

(7) Assessments and property-related fees imposed in accordance with the provisions of Article XIII D.

The only potential exception that the City of San Diego might try to use is #6 for "a charge imposed as a condition of property development." That particular phrase is a clear reference to development impact fees in Chapter 5 of the Mitigation Fee Act which are charged "as a condition of approval of a development project" (Gov. Code §66001(a)(b)) and imposed "as a condition of approval of a proposed development" (Gov. Code §66005). Thus *genuine*

development impact fees are excluded from Prop 26. But the City of San Diego will not be able to make the case that its Linkage Fee is a development impact fee ("DIF") charged "as a condition of property development."

To start, there is no record or evidence that the City to this point has ever attempted to characterize its Linkage Fee as a DIF. A review of the original 1990 Ordinance creating the Linkage Fee shows that the purpose of the Fee is to implement the General Plan and specifically the Housing Element of the General Plan, to provide more housing for lower income working households in San Diego. The Ordinance, and the Municipal Code sections it creates, cite the State Constitution "police power" authority under Art. 11 §7 as the legal authority to create the fee (which is typical of the authority used in past years for "regulatory fees") while making no mention of the Mitigation Fee Act ("MFA") whatsoever. Normally when cities adopt explicit development impact fees their authorizing ordinance or resolution will make specific "reasonable relationship" findings under §66001 of the MFA that: there is a "reasonable relationship" between the fee's use and the type of development project on which the fee is imposed (§66001(a)(3), that there is a "reasonable relationship" between the amount of the fee and cost of the public facility attributable to the development on which the fee is imposed (§66001(a)(4), and that the fees do not exceed the reasonable cost of providing the services or facility for which the fee is imposed (§66005). None of those findings are made in the Ordinance for creation of the Linkage fees. Nor have I been able to find any evidence that the City accounts for the Linkage Fees as DIFs in accordance with the statutory requirements of §66001(c) and §66006 of the MFA, a failure which could theoretically subject the City to liability if in fact the Linkage Fees were DIFs.

Further, the fact that the Linkage Fees are paid in order to get a building permit does not make them fees paid "as a condition of property development." Case law has clarified that using the building permit merely as the collection point for the fee does not make the fee one which is paid "as a condition of approval of development" under the MFA and therefore a DIF subject to the protest and refund procedures of the Act. *Barratt American, Inc. v. City of Rancho Cucamonga* (2005) 37 Cal.4th 685, 695-699 ["*Barratt*]; *SJVAPCD*, supra, 178 Cal.App.4th at 130-131. In *Barratt* the California Supreme Court ruled that building permit and plan review fees were not DIFs notwithstanding that they had to be paid before issuance of a permit. In SJVAPCD the Court of Appeal ruled that air quality mitigation fees imposed on building permits by the Air Pollution Control District were not DIFs, because the fees were not imposed to in any way condition the project for which the building permit was issued, but rather to collect a regulatory fee for a regulatory program adopted under the "police power" authority given to the District. The Linkage Fee in this case operates exactly the same way, extracting money form commercial builders at the building permit stage for the purpose of funding the regulatory affordable housing program operated by the City of San Diego.

Under the MFA a DIF can only be created to fund public facilities or services which alleviate impacts that are attributable to the development which

pays the fee. (Gov. Code § 66001; *Barratt*, supra, 37 Cal.4th at p.696). Here again the Linkage Fee falls short because it cannot be said that construction of a commercial building actually causes a shortage of affordable housing in the City. Even the Keyser Marston Nexus Study stops short of claiming that commercial buildings *cause* job growth and shortages of affordable housing, instead framing the role of commercial construction as a "condition precedent" to job growth which brings workers requiring housing. (See Study at p.7.) In *Trinity Park v. City of Sunnyvale* (2011) 193 Cal.App.4th 1014, 1040-1041 {"*Trinity*"] the Court of Appeal examined whether an affordable housing set-aside requirement (which also could be satisfied by payment of an in-lieu fee) was an "exaction" under the MFA subject to the MFA protest and refund procedures, or rather was a regulatory requirement imposed under the "police power." The Court reviewed the purpose of the affordable housing set-aside and the public welfare aspect of the program, and determined that *nothing indicated that the below market housing requirement was intended to "defray all or a portion of the cost of public facilities related to the development project."* (§66000(b) – definition of a development mitigation fee) The affordable housing requirement was not designed to alleviate the effects of the development but instead was imposed under the "police power" to further the goals of affordable housing in the City under its regulatory program.

After the City of San Diego collects the Linkage Fees they go to a separate account in the Housing Fund, but from there they are spent just like other funds and resources available to the Housing Commission, going to any of a large number of activities from actual construction of housing, to rental assistance, relocation payments, grants and loan underwriting for home purchasers, emergency homeless shelters, rehabilitation of existing housing, lead clean up, disability access improvements, technical assistance to nonprofits working on affordable housing, assistance to the elderly and veterans, and the list goes on. The Linkage Fee funds are only one of many sources of revenue to support the Affordable Housing Program, which are essentially commingled in the overall effort and matched with private contributions, government grants, etc., to "leverage" the funds by a factor of 7 to spend on projects and activities (ie. every $1 of Linkage Fee revenue is leveraged with the addition of $7 of funding from other sources). While to some degree the effects of the program can be measured in relation to physical facilities built or activities carried out, in large part there are no metrics that can reliably gauge the impact of the program in relation to the dollars put into it. If it were an impact fee the public agency would be required to be able to identify the "public improvements" that the fee will be used to finance at the time the fee is collected (Gov. Code §66006(f)); but that would be impossible and probably undesirable for Linkage Fees, which require flexibility so that they can be leveraged with other funding resources as those resources become available. And, unavoidably the program addresses both existing deficiencies in affordable housing as well as housing needs anticipated for future growth; whereas a true "impact fee" is prohibited from collection for "existing deficiencies" (Gov. Code §66001(g).) The Linkage Fees

and their use in the Affordable Housing Program do not "fit" the legal structure of a development impact fee under the Mitigation Fee Act. In my opinion the 6th exception in Prop 26 for "a charge imposed as a condition of property development" cannot be stretched to cover Linkage Fees.

There are no exceptions to the definition of a "tax" in Prop 26 available for the Linkage Fee. It is, in effect, a regulatory fee dinosaur ready to meet Constitutional extinction. From a public policy standpoint reasonable people may debate the efficacy of this type of program and whether it might be worthy of perpetuating as a tax. But the starting point of that discussion is that a revenue raising device of this kind has to be approved by a 2/3 vote of the electorate as a special tax. The City may be able to continue the existing Linkage Fee which predates Prop 26. Any change or increase of the Linkage Fee will trigger Prop 26 and require a vote.

The *Koontz* decision

Suppose that the courts decide, for whatever reason, that Prop 26 does not apply to the Linkage Fees. The recent ruling of the U.S. Supreme Court in *Koontz v. St. Johns River Water Management District* –- S.Ct. ---, June 25, 2013 WL 31842628 (U.S.Fla.) ["*Koontz*"] establishes newly defined constitutional requirements for *monetary exactions as a condition of land development*, which must be satisfied for collections of the Linkage Fee to not be deemed unlawful "takings" in violation of the 5th Amendment of the U.S. Constitution. The City and Keyser Marston have relied on the pre-*Koontz* case law, in particular the *Commercial Builders* decision, to support a Linkage Fee which has only a general associational relationship between the fee and affordable housing as its "nexus," as well as the proposition that non-proportional fees can be charged as long as the amounts collected in the aggregate are less than the total mitigation cost derived from their calculations.

In *Koontz* the property owner requested drainage and wetlands mitigation permits from the District to allow him to develop 3.7 acres on his 14.9 acre property. The District demanded as part of the process of imposing standard conditions on issuance of the permits that he either restrict his development by an additional 2 acres or pay the District for unrelated offsite mitigation work that would enhance about 50 acres of land owned by the District. Koontz found the District's demands excessive and on his refusal to agree his permits were denied by the District. Florida law allows a claim for damages for unconstitutional demands by public agencies, so Koontz sued. The issue presented to the Court was whether the District's demanded exactions –particularly the monetary demand—should be examined under the "heightened scrutiny" review of Nolan/Dolan. The majority of the Court decided that "heightened scrutiny" is applicable. The minority of the Court felt that Nolan/Dolan scrutiny was not warranted for a "monetary exaction," nor where the exaction was not clearly an ad hoc individualized determination that maximizes the risk of extortionate use of the police power right to demand concessions. The majority opinion, however, finds that, in the context of conditions placed on the development of land,

"monetary exactions" are just as deserving of constitutional protection as demands for an interest in real property, and there is no reason that protection should not be given to legislative "impact fees" and other standard conditions placed on land development that have become commonplace methods of funding public improvements. The Court noted that, contrary to the warnings of the minority opinion that "heightened scrutiny" would have calamitous consequences for municipal finances and the ability of cities to fund infrastructure, many states around the country have been applying *Nolan/Dolan* "heightened scrutiny" to impact fees and legislative exactions on land for years, without any evidence of it causing financial ruin in those states.

The "heightened scrutiny" now required by the *Koontz* decision demands that an exaction placed on land development have an "essential nexus" to the impacts/harm to be alleviated by governmental expenditure of the exaction funds, and that the amount of the exaction have "rough proportionality" to the impact/harm it is intended to mitigate. In California and in the 9th Circuit this is a dramatic change in the law. *Commercial Builders of Northern California v. City of Sacramento* (1991) 941 F.2d 872 ["*Commercial Builders*"]; *McClung v. City of Sumner* 548 F.3d 1218 (2008) ["*McClung*"]

In *Commercial Builders* the City of Sacramento passed a Linkage Fee ordinance that conditioned nonresidential building permits on payment of a fee to offset the burdens associated with the alleged influx of low-income workers to work on such developments and the demand for low-income housing. The plaintiffs *Builders* claimed that the ordinance worked an unconstitutional taking because there was an insufficient showing that non-residential development contributes to the need for low-income housing and that the amount of the fees was not in proportion to any alleged burden on housing. But the 9th Circuit held that a *legislative monetary exaction* should not be invalidated unless there "*no rational relationship*" or "*no evidence of a nexus*" between the development and the problem that the exaction seeks to address. Keyser Marston also prepared the linkage fee nexus study in this case. The Court found that the nexus study, even though it admitted that building construction is not responsible for growth, was sufficient to meet this extra-ordinarily lenient nexus standard. The Court also accepted the proportionality of the fee as it was much less than the total amount of a potential fee that the study claimed to be authorized. Generally the Court regarded the fee as a legislative act that required deference from the court, and – ignoring the crucial distinction that the legislation extorts money for exercising the right to develop property—gave the fee the same deference it would give in refusing to interfere in ordinary legislation.

More recently (2008) in *McClung,* the 9th Circuit reviewed a development condition of general application passed by the City of Sumner that required the builder to install a 24 inch storm drain pipe, even though the property development did not need a pipe of that size or expense. The Court made the explicit determination that *Nolan/Dolan* "heightened scrutiny" does not apply to monetary exactions (because "money is fungible") as contrasted with dedications

of land, nor does it apply to legislative exactions of general application as opposed to ad hoc or adjudicative individualized exactions. The *McClung* court cited with approval the decision in *Commercial Builders* among cases it believed to be correctly decided on these principles. (*McClung* at 548 F.3d 1228.)

Koontz explicitly abrogates *McClung* (p.22 of *Koontz* decision) and by implication therefore also abrogates *Commercial Builders.* The anticipated Linkage Fee increase in San Diego accordingly must be reviewed under "heightened scrutiny" to determine if there is an "essential nexus" and "rough proportionality" to the effects of the proposed land use. The more demanding "essential nexus" from *Koontz* and *Nolan/Dolan* requires more than a general associational relationship between the development activity (commercial building) and the impact/harm to be alleviated (unaffordable housing) which otherwise might clear the low bar of "no evidence" or "no rational relationship" set in *Commercial Builders*. Moreover, the amount of fee cannot be arbitrarily set for administrative convenience, as it is now; nor can the proportionality of fee collections in either the individual case or in the aggregate be ignored, much less glossed over on the false assumption that total fee revenues are less than what might be demanded. The Linkage Fee fails both prongs of "heightened scrutiny" now that *Koontz* is the law of the land.

- "Essential Nexus"

The "essential nexus" prong of *Koontz/Nolan/Dolan* demands a "substantial connection" between the public burden created by the construction and the necessity for the exaction. *Surfside Colony, Ltd. V. California Coastal Comm.* (1991) 226 Cal.App.3d 1260, 1267. The strength of that connection must "substantially advance" the state interest served by imposing the exaction. *Nollan*, supra, 483 U.S. 825, 834-835. While the case law does not necessarily require that the construction be the *sole* cause or an absolutely *direct* cause of the public burden, it is clear that the nexus analysis must show a *cause-and-effect relationship* between the two. In this regard the dissent by Justice Beezer in *Commercial Builders*, a dissent now vindicated by *Koontz*, was on target in stating (*Commercial Builders, supra*, 941 F.2d at 877):

> Sacramento has commissioned a study that demonstrates at best a tenuous and theoretical connection between commercial development and housing needs. But the Takings Clause requires a cause-and-effect relationship between the two. *Pennell v. San Jose,* 485 U.S. 1, 20, 108 S.Ct. 849, 862, 99 L.Ed.2d 1 (1988) (Scalia, J., dissenting). In my view, Sacramento has not shown such a relationship. Even the study relied on by the city to support the ordinance states that its "nexus analysis does not make the case that building construction is responsible for growth."

The issue arose again in *Surfside, supra*, where the California Coastal Commission demanded a lateral access beach easement as a condition of the

permit allowing construction of a revetment[2] to protect against erosion on the beach front of the Surfside Colony housing development. The "nexus" for the Commission's exaction of an easement was the assertion that the revetment would exacerbate erosion in front of the revetment (which was built on an emergency basis and therefore completed before the Commission's administrative proceedings were completed). The Commission had several scientific studies concerning the effects of revetments; some of the studies indicated that revetments accelerate erosion of the beach in front of them, leaving the beach steeper, more narrow and "perched"; while another study indicated that beach erosion was more complex and variable, depending on localized factors like wave conditions, sand supply, bedrock, etc., so that a "rational" determination of the effect of a revetment can only be made by a site-specific analysis. The Colony submitted an expert report to the Commission that asserted that this particular revetment did not exacerbate erosion and in fact stabilized the beach. In addition the Commission was given pictures of the revetment (which was built in November/December 1982) showing the revetment in January 1983 with an eroded beach in front of it, and in July 1993 with the sand having come back and covered over the revetment so that it was not then visible. (In essence, the revetment here was actually restoring an already damaged beach front rather than exacerbating erosion.) Nonetheless the Commission, which takes the general policy position that revetments exacerbate erosion and discourages them, voted to maintain the easement exaction. Colony sued, and the trial court upheld the exaction.

The Court of Appeal in *Surfside Colony* reversed the trial court decision, focusing its decision on the strength of the essential nexus required by *Nolan*. It found "there must be a **solid connection** between the public burden created by coastal construction and the necessity for a public easement." (emphasis added; *Surfside Colony*, 226 Cal.App.3d at 1263.) Stating further (Id. at 1267, fn.10):

> The strength of the connection required by *Nollan* is not spelled out in so many words, but appears to be **at least a substantial one.** At 483 U.S. at pp. 834–835, 107 S.Ct. at pp. 3146–3147 the court indicates the need for a "substantial" connection between the public burden imposed by the proposed construction and the condition imposed by the government: "Our cases have not elaborated on the standards for determining what constitutes a 'legitimate state interest' or what type of connection between the regulation and the state interest satisfies the requirement that the former 'substantially advance' the latter. (emphasis in original)

The Court then distinguished *Whaler's Village Club v. California Coastal Comm.* (1985) 173 Cal.App.3d 240, which had upheld the Commission's policy of exacting public access easements for the construction of revetments, but was decided before *Nollan*. *Whaler's Village* had employed a "rational basis" test and had determined that it was enough that the project incurred "incidental" effects on the public's right to shoreline access. The *Whaler's Village* court stated (at 173 Ca.App.3d 260-261) "the validity of the condition is not destroyed

[2] A revetment is a sloping structure or fortification placed on the shoreline to disrupt the force of waves and protect the beach land from erosion or loss.

because the development has no *direct* nexus to the condition, the benefit to the public is greater than to the developer, or future needs are taken into consideration. It is enough that the project 'contributes in an incidental manner to the need for a particular extraction." The *Surfside Colony* court found that the foregoing holding of *Whaler's Village* no longer controls in light of the nexus requirements of *Nolan* for a **"close connection"** or **"substantial relationship"** between the burden and the condition. Then after rejecting the Commission's legal arguments that an indirect or incidental relationship is sufficient, it found that in the absence of evidence that revetments necessarily *cause* accelerated beach erosion, there could be no finding of the legally required nexus in the case before it. Accordingly the Commission's exaction of an easement was an unconstitutional taking.

The Linkage Fee in San Diego suffers from the same infirmity. It cannot be said that construction of a non-residential building necessarily *causes* an increase in unaffordable residential housing. Even the Keyser Marston Nexus Study will not go that far. It characterizes the effect of non-residential construction as a "*condition precedent to growth,"* (Nexus Study p.7); and of course it is that "growth" which increases resident workers, and in turn allegedly exacerbates the lack of affordable housing. Yet there are numerous factors which would also be considered "*conditions precedent*" to growth and are of equal or greater importance in that respect. Water supply and sewage treatment capacity, which are in finite supply, have to be ramped up with growth and are even more essential for new workers to even be able to come to San Diego. Police, fire and medical services have some elasticity of supply but can only be stretched so far before a shortage inhibits any further growth. Transportation facilities and telecommunications facilities also have capacity limits that require expansion to serve a larger work force, and without availability of those expanded facilities new workers will not move to San Diego if they cannot effectively travel both in and going out of the City or if they cannot effectively communicate due to inadequate telecommunications infrastructure. A competent city administrator will tell you that for growth to occur *all* of these "conditions precedent" (and many more) have to be in place, and even then there is no assurance that growth will happen.

When the Linkage Fees were reviewed by the City's Independent Budget Analyst in July of 2011[3] it was noted that:

> The basic premise of the Nexus Study is that new jobs create a need for additional affordable housing. In this context, **commercial construction is used as a proxy for job growth**. (emphasis added)

Indeed, commercial construction is viewed by the City of San Diego not as a real cause of job growth or unaffordable housing, but rather as a convenient "proxy" (that has deep pockets to be tapped for the City's housing program. Commercial construction at most has only an *indirect* or *incidental* influence on the growth which brings new workers. But that tenuous and vague connection between the imposition of the Linkage Fee and the problem of lack of residential

[3] See IBA Report Number 11-43.

affordable housing in San Diego cannot survive the "essential nexus" test now required to be applied by *Koontz*. There is no basis in reality to find a "close connection" or "substantial relationship" between the problem of unaffordable housing and commercial construction.

- **"Rough Proportionality"**

Beyond the "essential nexus" the *Koontz* decision also requires that the City show that the Linkage Fees are exacted in a manner that has "rough proportionality" to the alleged public burden created by the construction of commercial buildings. There are two aspects to "rough proportionality": (1) proportionality for the individual fee payer on a commercial construction project, that assures that the individual fee payer receives an exaction that is roughly proportional to the burden created by that individual fee payer for that project; and (2) "proportionality" for all commercial construction fee payers in that the total fee revenues exacted from all commercial construction should not result in payment over and beyond the total public burden created by commercial construction in the City.

---- individual rough proportionality

The "heightened scrutiny" now required by *Koontz* makes a huge difference for individual fee payers. California case law in the past generally allowed legislatively created fees to be exacted from individual fee payers without regard to whether the amount of the fee is proportional to the public burden created by that *individual* fee payer, as long as there is some rational basis for establishing the fee amount (as opposed to a completely arbitrary, random, or discriminatory method for setting the fee amount), and provided that the total of all fee revenues did not exceed the total public burden costs for which the fee was collected. *California Association of Professional Scientists v. Department of Fish and Game* (2000) 79 Cal.App.4th 935 ["*CAPS*"]. According to the Court in CAPS "Proportionality is measured collectively to assure that the fee is indeed regulatory and not revenue raising." (*CAPS* 79 Cal.App.4th at 948.) The fee in *CAPS* involved the filing fee for environmental documents of (at that time) $1,250 for a negative declaration and $850 for an EIR. In theory the fee pays the costs of the Department of Fish and Game to review environmental documents and also projects to ensure that fish and wildlife resources are adequately protected. Despite proof in the trial court that 80% to 90% of all fee payers receive no review of documents or their projects, and about 10% of all fee payers (large government public works projects, large corporate timber harvests and major multi-jurisdiction development projects) cause almost all of the public burden, the fee was upheld on the grounds that the total amount of fee revenue collected was not more than the total costs of the Department for those activities, and beyond that there is no constitutional protection for individual fee payers other than a required "rational" basis for setting the fee amount.

The *CAPS* case and its progeny are of no value today because "regulatory

fees" such as those contested in *CAPS* are now "taxes" pursuant to Prop 26. More important to the current inquiry, *Koontz* abrogates cases which followed CAPS insofar as an exaction is levied *as a condition of developing land*. That is to say, the "heightened scrutiny" requirement of *Koontz* applies to the individual fee exactions that are now made as conditions to develop land, and on an individual level the fee must be roughly proportional to the public burden created by development. The Linkage Fee in San Diego fails this test.

Putting aside for a moment the fact that a "nexus study" for a social program to intervene in market-based economics has no place in the "impact fee" law nor any likely predictive value, the Keyser Marston Nexus Study is erroneously structured around the old law. It appears to be designed in a manner to allow politicians a free hand to set individual fees to any level or by any metric, guided only by their desires or deal-making with interest groups that may be involved. The Study describes a process of analysis, by which the consultant strung together a chain of assumptions about the future of San Diego's economy, job market, housing patterns, etc., and then combined that with estimated calculations of resident worker incomes in future commercial buildings matched with the cost of providing "affordable housing" to *all* of them, to arrive at a huge but implausible cost number as the potential "maximum fee" that allegedly could be collected from commercial builders. The "maximum fees" are so high and draconian that their imposition would make any commercial construction cost-prohibitive and create a de-facto moratorium on commercial construction altogether. (For example "office buildings" are shown as subject to a potential maximum fee of $72.41/sq.ft.) The stratospheric "maximum fee" is thrown up impliedly as a threat[4], then the consultant advises (relying on the pre-*Koontz* law) that the City has a free hand to set the actual fee at any level below the ceiling of the "maximum fee" using any convenient metric (Study p.51-62). Of course, any criticism of the much lower fees recommended by the Study for individual fee payers is met by the admonition that the fee payers are fortunate they aren't paying the "maximum fee."

The Linkage Fees ultimately recommended by Keyser Marston are set at 1.5% of total development cost -- resulting in fee levels that are increased from the current fee by about 500% across all 5 building types, but still under 10% of the "maximum fee." The rationale given for the recommended metric is "market absorption" along with administrative convenience. The consultant believes that the recommended fee (for example "Office Buildings" at $5.32 per sq.ft.) will not impact development decisions; ie. that a fee at that level is low enough that commercial builders will not choose to move commercial construction to locations outside the City. The metric based on total development costs is a convenient tool for calculation and one the City can follow. But in this respect the Keyser Marston Study is badly mistaken and somewhat cavalier in recommending to the City that it can set Linkage Fees at any level below the maximum nexus cost and use any metric it finds convenient.

---

[4] Though the "maximum fee" is held out as a threat, even the consultant acknowledges that any fees greater than 10% of that level will likely drive commercial development to locations outside of the City (Study p.62) -- which means the "maximum fee," or anything close to it, if ever instituted would never be collected.

The recommended metric of *% of development costs* has no connection whatsoever to public burdens created by construction of commercial buildings, and the Study doesn't attempt to show a connection. That particular metric is remarkably similar to the "cost of construction" metric that at one time was used, based on the old Uniform Building Code Valuation Tables, to set building permit and plan check fees, but was found by the Attorney General to have no basis in reality or cost analysis, and could not serve as a basis to support the legitimacy of a fee. 76 Ops. Cal. Atty. Gen. 4, 1993 WL 112941, Opinion No. 92-506. Likewise there is nothing in the Keyser Marston Study which attempts to support use of this metric other than convenience. To complicate it further, even the Keyser Marston Study and the Independent Budget Analyst acknowledge that this metric does not correspond by types of buildings to the Study's measures of the relative public impacts of different types of buildings, so that even under their own theory of fees this metric can't possibly be "proportional" much less accurate.[5]

---- collective rough proportionality

Collective proportionality means that the City cannot collect more total fee revenues than the amount that is "roughly proportional" to the public harm caused by all commercial construction subject to the fee. In this regard the Keyser Marston Study puts up figures for total costs and "maximum fees" that are wildly unrealistic, though covered by a veneer of seemingly scientific econometrics that produce numerical results. To arrive at numerical results the Study had to substitute assumptions and leaps of logic for facts. The accuracy and reliability of the results must be judged from the context of the subject matter at hand. The subject matter here is not an impact fee for public infrastructure like a water treatment plant or a bridge. Genuine impact fees are used for public amenities that *do* lend themselves to scientific quantification of costs, along with reasonably accurate quantification of the public burdens created by fee payers. However, an assessment of the impacts of commercial construction on the availability of "affordable housing" is an exercise –-from start to finish— in speculative economic theory. For example, three key variables in the analysis of "housing affordability" –--housing prices, employment level, wage/income level--- are highly variable and driven by private market forces beyond the control of San Diego City government. The need for and amount of some sort of "fee" to react to the combined effects of these unpredictable factors is just as difficult and unreliable to predict as the undergirding factors. This exercise might be useful for the rumination of policy makers but it provides no factual basis for an impact fee, nor can it yield a reliable calculation of impacts for affordable housing costs that can be adjudged "roughly proportional" to the need allegedly caused by commercial construction.

---

[5] Because of the differing employment mix there are significant differences among the building types as to impact on affordable housing. The Study purports to find that 94% of Retail and 93% of Hotel workers need housing assistance, whereas 56.2% of Office and 52.7% of Manufacturing/Industrial workers need assistance.

The Keyser Marston Nexus Study does not overcome the inherent uncertainty of market prognostication, and instead compounds the unreliability of its predictions with flawed assumptions and major oversights that make the final calculation of a "maximum fee" grossly excessive, legally indefensible, and in no way "roughly proportional" to the purported public burden on affordable housing related to commercial construction. Some of these errors in the Study are quantifiable, some are not but might be fleshed out by further research/analysis, and some are incapable of quantification. All told the Study is fatally flawed.[6]

Errors in the "Nexus Study" calculation of a gross fee amount and proportionality:

- Narrative assumption—equal/worsening future affordable housing availability:

The early sections of the Study present a gloomy forecast of the future of housing affordability in San Diego (the Study purports to be long term in nature, maybe 30 or 40 years [?] but never explicitly states its planning horizon) predicting that job growth and affordable housing demand will outstrip housing production generally, and affordable housing in particular. Aside from the fact that these are crystal ball predictions to begin with, the Study oddly places a heavy emphasis on retiring baby boomers –aged 65 to 85-- as primary culprits in causing the shortage (see p.26). According to the Study assumptions these workers drop out of the workforce at 65 but stay in their homes, becoming in effect "dead weight" that occupies housing while their replacements in the workforce search for housing of their own. The Study estimates the negative affordable housing impact of the "dead weight" retirees to be even *greater* than the new housing demand from projected long term job growth (52% of housing demand attributed to retirees and 48% attributed to projected job growth).

If this were true, and if one were to heartlessly follow these econometrics, the solution to affordable housing would be either a tax on retirement in San Diego or an incentive program to get seniors out of town. But reality is more complex and compassionate. Workers who are valued by their employers don't necessarily retire at 65, especially if their income level has a bearing on their housing affordability. Some workers leave behind jobs that are not replaced because the job itself is obsolete or the work has been sent "off shore" to save costs. Gradations of "semi-retirement" are commonplace today, as is new part-time employment by workers over the age of 65. After those workers do retire they don't stay in their housing till age 85. As they age they transition into different options for senior housing, with different levels of independence or assisted care. The average life expectancy of San Diegans is 80. Between the ages of 65 and 80 and beyond, a large proportion of those seniors will leave their previous housing, making it available again on the market for projected new workers. The Nexus Study has no analysis of that dynamic, and instead carves out a huge block of 52% of housing as if it were lost.

---

[6] Perhaps in defense of Keyser Marston it may be said that it just isn't possible to do a legitimate "nexus study" for housing affordability.

Second, the pessimistic long term predictions of the Nexus Study run counter to the goals and objectives of the City of San Diego as adopted in the Housing Element of its General Plan. State law requires the City to thoroughly analyze all facets of the affordable housing challenge, make plans for action, and take specific measures to the full extent of the City's municipal powers to resolve the deficiency of affordable housing (see Gov. Code §65583). And it is an ongoing recursive process of evaluation of results, plans, further action, and review again, until the stated goals and objectives are achieved. The multitude of plans, programs, and initiatives aimed at affordable housing, including partnerships with private non-profits and intergovernmental efforts, are too numerous to describe; but all are focused on that same goal. Given the City's legal mandate to move forward, one should assume that eventually progress will be made and if not a near term solution at least inroads will be made that *reduce* the affordable housing deficit. To assume otherwise, as does this Nexus Study, is to say the City's affordable housing efforts in the Housing Element will *fail*.

By assuming failure of the City's overall efforts to ameliorate shortages in affordable housing, the Nexus Study all too conveniently ignores the job of estimating that progress in reducing the need for affordable housing—which would have to be accounted for as an offset to the future housing needs of the future workforce that comes to work in new commercial construction. That is an indispensible element if one is going to engage in this analysis. As now framed the Nexus Study is calculated as if commercial construction (somehow) brings 100% of the future workforce to the City, and then is responsible for 100% of their future affordable housing, with no thought given to the fact that there is both a legal mandate for the City and major parallel efforts to provide affordable housing that will reduce the cost basis for calculating this Linkage Fee. This omission by itself causes the Nexus Study to be fatally flawed.

• <u>Failure to account for "leveraging"</u>

The Nexus Study falsely assumes that dollars collected through a Linkage Fee will be the sole source of funds for funding/purchasing the affordable housing allegedly needed to address the impacts of commercial construction. However, as recognized and noted by the San Diego Housing Federation (November 8, 2010 letter supporting increases in Linkage Fees) "Linkage Fees have historically been leveraged 8 to 1 with outside funding sources."

"Leverage" is a good thing. But ignoring it in a nexus study is not. Calculation of the actual or estimated total cost of affordable housing required to ameliorate the alleged impact of commercial constriction is dishonest if it doesn't take into account the "leverage" from other funding contributors, which in fact reduces the dollar contribution required from commercial construction in the form of Linkage Fees. Properly accounting for this factor alone reduces the fee calculation by about (8/9) 89%.

• Violation/Lack of Municipal Code Authority

The Nexus Study is directed at affordable housing for a "target population" for which the San Diego Municipal Code does not allow calculation or imposition of a Linkage Fee. Article 8, Division 6 of the San Diego Municipal Code provides the current municipal authority for imposition of Linkage Fees (referred to there as "Housing Impact Fees"). §98.0601 clearly states the purpose and scope of the fee program, which is to address the housing needs of "the **low and very low income employees** who will occupy the jobs new to the region…" (emphasis added). §98.00604 defines "Low Income" as 80% to 50% of the area median income ["AMI"], and "Very Low Income" as income at or below 50% of AMI (as adjusted for household size). That is the "target population" to be served by Linkage Fees as authorized by the San Diego Municipal Code. No authority is given in the Municipal Code to impose Linkage Fees for the benefit of any other demographic group.

The Keyser Marston Nexus Study, however, adds a new layer to the foregoing "target population" by further including "Moderate Income" workers, defined as having income at 80% to 120% of AMI. In that range a family of four would have an income of $66,100 up to $91,100. The new layer would be a major increase in the "target population" for all five categories of non-residential buildings: for "Office"+43%, "Hotel"+9%, "Retail"+11%, Manufacturing/Industrial"+44%, Warehouse/Storage"+31%. Because the Nexus Study does not perform a separate calculation of the final Linkage Fee without the "Moderate Income" component, and the Study does not include or show all the calculations used in reaching its conclusions for a fee, it isn't possible to discern from the Study what the Linkage Fee would be without that component. Regardless of the precise amount of the proposed Linkage Fee that is represented by "Moderate Income" workers, it is clear that it has the effect of substantially increasing the Fee at least 15%--30%, without any current legal authority in the Municipal Code to support a Fee at that level.

It would not be possible for the San Diego City Council to approve an increase of the Linkage Fee in accordance with the recommendations of the Keyser Marston Nexus Study unless it simultaneously amends the San Diego Municipal Code. As currently calculated and presented the Fee cannot be legally adopted.

• Social Welfare Program

A Linkage Fee that is expanded to provide housing assistance to workers earning up to 120% of the area median income takes on a scope which abandons any pretense that is other than a social welfare program. As noted in the Study itself, 56% to 94% of all worker households in San Diego would qualify for

public affordable housing assistance. (Study p.32) Housing assistance would be the rule and not the exception for City residents. Whereas an impact fee

program on a smaller scale would be designed to *react* to the housing market to bridge what the Study describes as the "affordability gap," a housing program that takes in the vast majority of San Diego residents does not *react* to a market so much as it *creates* its own market. At that point it can't be argued that the Linkage Fee is an impact fee. It is simply a funding source (though not legally collected) for a broad-scale social benefit program.

Intervention in the housing market on this scale can and likely would dramatically distort the local housing market over time, also undermining economic assumptions made in the Study. When the City becomes the dominant builder/supplier of affordable housing the overall cost of creating affordable housing will increase because historically in San Diego the production cost of affordable housing is roughly 35% higher per person housed than privately produced market-rate housing. ("Comparison of Market-Rate and Affordable Rental Projects," Bay Area Economics, 1993), though the price offered to tenants or purchasers for subsidized housing will remain "affordable." The perverse effect is that high quality publicly subsidized housing will drive all privately produced housing otherwise targeted to an "affordable" demographic out of the market. The subsidized housing stimulates demand at the low end of the market at the same time that supply substantially decreases, because residential builders as "rational actors" in the economic market will not waste resources at the low end and instead will produce housing aimed at the non-subsidized market. The net result is that "affordable housing" becomes more expensive as a public good and at the same time less available.

As private affordable housing production flees the market a question is raised as to whether City subsidized housing can fill the void and whether the public cost is "sustainable." Given that public resources are not inexhaustible (and the resistance of taxpayers to compensate for public overspending), the probable effect of broadly available public construction and subsidies for "affordable housing" to residents with incomes up to 120% of the median income is an environment of *perpetual shortages of affordable housing*. (See "Addressing California's Affordable Housing Shortage: Alternatives to Proposition 1 C," Gilroy, Summers, and Staley, Reason Foundation, 2006.)

The assertion by reputable analysts that such broad-based government intervention in the economic market for housing is counter-productive, may be questioned by some as resting on speculation about the behavior of future market conditions. But the same may be said of the "predictions" in the Keyser Marston Nexus Study, which are presented as highly quantified "impacts," but with no more (and actually less) scientific reliability. This does not make the general issue of "affordable housing" less valid or the need for housing less of a priority. It does mean that the policy issue and the funding mechanisms for "affordable housing" have to be addressed in the public forum in a *more serious way,* where the electorate can make its voice heard in setting priorities and determining how much the public collectively should pay to support

"affordable housing" and what form that should take. Widespread public benefit programs such as that suggested by the Keyser Marston Study for Linkage Fees can only legally be funded by *taxes*—a requirement that assures public discourse and approval not only required by the California Constitution (Art. XIIIC §1) but also appropriate given the cost and transformational nature of such a program.

• "Coming and Going" – Inclusionary Housing

At the same time the Nexus Study calculates fees for commercial construction that workers occupy, it turns a blind eye to the residential side of the equation where the City's "Inclusionary Affordable Housing Regulations" (San Diego Municipal Code §142.301 et seq.) require a 10% set-aside of new dwelling units for affordable housing. The inclusionary housing contributed by private builders on the residential side of the market is a key component of the City's program to address the affordable housing deficit. That contribution is not accounted for in the Nexus Study. Consequently for the many resident workers who have benefited and will benefit from living in inclusionary housing the City would levy a housing exaction twice, both "coming and going," first at home (inclusionary housing—funded by the residential builder) and then again at work (Linkage Fees – paid by the commercial builder).

The contribution of inclusionary housing significantly reduces the total cost target to be theoretically addressed by Linkage Fees. The precise amount of offset can't be said without further study and actually giving attention to it. Suffice to say that the cost calculation for the Linkage Fee is not valid when this factor is ignored.

• Government Workers

Another glaring omission in the Nexus Study is the failure to account for the affordable housing demand created by government workers and the exemption from the fee given to government buildings. The Bureau of Labor Statistics estimates that government employment for the workforce in the San Diego-Carlsbad-San Marcos market is about 15%. Though the Linkage Fee in San Diego is collected only on non-government commercial construction, the demand for and consumption of affordable housing by government workers is substantial. That demand for housing is "hidden" in the calculations of the Keyser Marston Study insofar as it is subsumed in the overall workforce demand estimates. The net effect is a significant but unrecognized hidden subsidy to government workers and government agencies at the expense of workers in private commercial buildings and commercial builders.

Accounting for government workers and appropriately reducing the fee burden attributed to private sector workers would require a significant reduction in the Nexus Study fee calculations, likely in the range of 15%. Absent consideration of this factor (*inter alia*) the recommended fees are not valid.

• Intra-City Job Movement and Circulation

The Nexus Study falsely assumes that a new commercial building will be occupied only by "new" workers from outside the City who are drawn to San Diego to work, and if any workers come from within the City then the building space they came from will be vacated and occupied by "new" workers to the same effect. While its true as a general proposition that the workforce is expected to grow in the future, its also true that a city of 1.3 million people has a constantly circulating intra-city flow of businesses and workers within the City boundaries. It is also true that different business uses have widely differing employee densities per sq. ft. of commercial space (as acknowledged by the Nexus Study itself), and vacated commercial space (especially on the low end) is not automatically re-used as commercial space or used again at the same employment density. There is *no data* to support the Nexus Study assumption of 100% "new" outside workers or 100% replacement of intra-City workers with 100% "new" workers. In fact common sense dictates otherwise, though it is unclear if data has been collected on the true percentages of "new" workers.

Rather than dig out the actual data for "new" workers the Nexus Study makes the completely arbitrary and overstated assumption that all workers are "new." This is convenient for purposes of compiling the Study but it is a fatal flaw that invalidates the results.

• The "Wealth Effect"

Normally job growth from an improving economy is considered a good thing, but in San Diego –at least from the perspective of the Nexus Study—it is the source only of negative impacts in regards to affordable housing. What is not considered in the Nexus Study but should not be discounted or ignored, is that income growth from job creation will lift workforce wages and incomes so that more workers than before will be able to "afford" their housing. This "wealth effect" is significant but completely unaccounted for in the Nexus Study. Importantly, the "wealth effect" is most closely associated with surges in new commercial construction, as the two go hand-in-hand.

The "wealth effect" can be counteracted only by commensurate escalation in affordable housing market prices. Though it may be suggested that increased incomes and workforce numbers may increase demand for affordable housing, and the increased demand may increase housing prices, there is no indication of a 1-to-1 correlation or that increases in worker income are necessarily fully canceled out by increased housing prices.

The clearly implied assumption of the Nexus Study that income growth has no beneficial effect on housing availability is arbitrary and unsupportable. While the compound average annual population growth rate in the City of San Diego for the next ten years is expected to be 1.0%, the corresponding growth in median household income is expected to be 3.7%. (CBRE Consulting, Inc.; State of California Department of Finance.) Theoretically, all else being equal, San

Diego workers could "grow" their way out of the affordable housing deficit through rising incomes. Of course future market prices for affordable housing have to be considered. But the failure of the Nexus Study to address the effect of rising worker incomes is inexcusable and undercuts the reliability of the Study's predictions and proposed fees.

•Part-Time and 2 Job Employment

The Study has no discussion of part-time employment as a factor, nor workers who hold two part-time jobs. Because there is no discussion it is unclear but it would appear that part-time workers are not considered at all, and the portion of the workforce holding two part-time jobs would be missing as well. For good or ill these are growing segments of the workforce that have to be accounted for.

In the Keyser Marston analysis a retired worker who returns for part-time employment, for example, is no longer considered a "worker household" and instead is treated as a negative demand on housing by removing a unit of worker housing from the housing pool. Similarly, part-time employees in larger households do not have their contributions to eligible income counted, and those who may hold down two part-time jobs are invisible. Despite uncertainties of what that data may reveal, it is more likely than not that proper consideration of this segment of the workforce will increase the number of worker households in housing that, because of either their part-time income (usually combined with a full-time worker in the household) or low cost due to housing acquisition 20 or 30 years ago (many retirees), is actually "affordable," and also increase the income levels of a segment of households in regard to their needs for affordable housing. Failure to consider these part-time workers in the Nexus Study analysis incorrectly inflates the projected need to be paid for by commercial construction to a corresponding degree.

• Market Adjustments

Economic markets faced with shortages will inevitably react and make adjustments to compensate or overcome the shortage, if given an opportunity. The deficit in affordable housing is no different, and the two normal modes of adjustment are either (1) production of more affordable housing units by private builders in the City, and/or (2) commuting to work from residential areas outside the City that have a lower cost of housing. The first mode is the one most encouraged by City government in San Diego and in other cities, but at the same time private development of affordable housing –especially where any degree of public subsidy is provided-- is hobbled by regulatory requirements that substantially increase costs of production and discourage private sector investment.[7] The second mode is already extensively used in San Diego, with—

[7] See "The High Cost of Low-Income Housing," Gilbert A. Rosenthal, Wharton Real Estate Review, Fall 2011. Housing types for low-income housing are the same as the market but typically of *higher* quality initial construction to assure long-term durability and low maintenance. Design and construction has to accommodate policies/regulations that promote accessibility, visitability, and community spaces, requiring additional expense for grading, drainage, ramps and fixtures. Use of partial public funding often requires participation in construction of an SDBE and/or MBE and/or

as noted by the Nexus Study—over 40% of city workers commuting from outside locations.

A major flaw in this Study is the arbitrary assumption that the relative % of the workforce commuting now will remain the same as the workforce grows. If, indeed, housing is more affordable outside the City and the transit system presumably maintains its capacity to carry commuters, the incentive is for future City workers to commute in ever greater numbers than is done now. That is a significant change in the calculations used by the Nexus Study, because commuters living outside the City boundaries are not part of the "target population" and the City not obliged to provide them with affordable housing. The commuter % of the City workforce could, for example, easily rise to 60%-- a fact which would remove almost 1/3 of the "new" workers from the Nexus Study calculations. It is clearly probable that the commuter % will rise in coming years as the workforce increases; it is only a question of how much.

At the same time there will still be pressure for market adjustments, and in the Bay Area surrounding Silicon Valley in Northern California private company innovation has already made a significant impact on this issue. Over seven years ago, without fanfare and simply as an employee benefit, Google created what is probably the largest privately owned transportation network in the United States, using unmarked buses that ferry employees to and from the massive Google headquarters in Mountainview, Ca. The large municipal-size buses with comfortable seats, on-board WiFi and other amenities, reach out to the residential areas up to 60 miles away, stopping at convenient neighborhood locations, and burning bio-diesel as "green" fuel. Employees of Google regard it now as an essential feature of their employment, in part because housing in the Silicon Valley close to Google headquarters has reached astronomical prices. The Google bus system has been emulated by other Silicon Valley companies Apple, Facebook, eBay and Electronic Arts. While the Google model may not be economic for replication everywhere, it has obvious potential for use in San Diego by any large companies that may decide to locate their operations and bring their workforce to the City.

These market adjustments to affordable housing issues cannot be unknown to Keyser Marston. However, failing to take account of them discredits the assumptions used for their fee calculation and derivation of what they term a "maximum fee."

ALL FACTORS:

Consideration of all of the above factors that affect the "rough proportionality " assessment should leave no credible basis for the Nexus Study calculations to be used for setting fees. A mathematical exercise of applying all the reductions in the Study's fee amount that are warranted results in a figure

---

veterans; construction firms that don't meet those criteria will partner with qualifying firms; but every additional principal adds a layer of administrative cost. The public subsidy triggers "prevailing wage" requirements, escalating some if not all labor costs. Throughout the design and construction "approvals" have to be obtained from multiple agencies to assure compliance with policy objectives, causing delays and additional overhead cost.

well below what the Study recommends for fees to be adopted by the City. But legally even the hypothetical pursuit of a fee amount should be abandoned, because as explained above this exaction is a "tax" and nothing more. No amount of fiddling with the numbers will fix that.

SUMMARY & CONCLUSION

Linkage Fees are a financing mechanism for affordable housing that was legally suspect from the day they were conceived well over 20 years ago. But Californians are a patient lot, and the California courts and Ninth Circuit federal court went much further and leaned over backwards to uphold Linkage Fees in

Commercial Builders (1991) using a judicial standard normally reserved for challenges to legislation, forcing any challenger of Linkage Fees to prove that there is "no evidence" in the record to support them. Twenty years later after thousands of new regulatory "fees" and other *taxes* masquerading as "fees" had been enacted around the State, Californians rightfully lost their patience and reined in local government "fees" with the approval of Prop 26 (general election, November 2010). With specific exceptions so called "regulatory fees" are now taxes that must be approved by the electorate, and the burden is squarely on the local agency to prove by a preponderance of the evidence that a fee is not a tax. One of the "exceptions" in Prop 26 is directed to fees "for approval of property development," which would cover what we commonly refer to as "development impact fees." Though in the past the California courts have previously given those types of fees an extra-ordinarily lenient standard of review, the legal landscape changed with the U.S Supreme Court decision in *Koontz* just 3 months ago. Now under the *Koontz* (and *Nolan*/*Dolan*) standard of "heightened scrutiny" any monetary exaction as a condition to develop land must have an "essential nexus" to the purpose for which it is collected, and the fees must be "roughly proportional" to the public burden attributable to the development.

The Linkage Fees proposed now in San Diego are in my opinion nearly indistinguishable from the "regulatory fees" that proliferated before Prop 26 and are now designated as "taxes." The Linkage Fees are only vaguely associated with commercial construction, and the funds collected go into a giant regulatory program for affordable housing that has numerous funding sources, a long list of objectives, and a large group of participants –-both governmental and private—loosely coordinated to administer and spend money to improve opportunities for housing and shelter. If/when the validity of the Linkage Fee is challenged I would anticipate that the City will seek escape from Prop 26 via the exception for fees "for approval of property development." As explained in detail earlier in this memo I don't believe that exception to Prop 26 is applicable to the Linkage Fee. But even if Prop 26 is not applicable, the Linkage Fees would still have to meet the "heightened scrutiny" standard of *Koontz* that requires an "essential nexus" between the fee and its purpose, and "rough proportionality" as to the amount of the fee in relation to the amount of public

burden caused by the fee payer. Based on the information available to me today and extensive review of background materials related to the nature and structure of this Fee, I don't believe the Linkage Fee would survive judicial review under the "heightened scrutiny" standard required by *Koontz.*

While there cannot be any guarantee as to the outcome of litigation, I feel comfortable in advising you that the prospects for success of a legal challenge to an increase in the Linkage Fee are very good. If you or any of your members have any questions concerning the above analysis of the issues I would be glad to discuss it further. Thank you for the opportunity to review this most interesting assignment.

Very truly yours,

MCNEILL LAW OFFICES

WALTER P. MCNEILL